No. 15,110

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JOHN LUCAS HUDSON, SR., and PACIFIC-PALMDALE DEVELOPMENT COMPANY, a corporation,

Appellants,

vs.

WILLIAM A. WYLIE, as Trustee in Bankruptcy of the Estate of John Lucas Hudson, Sr., a bankrupt,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

PETITION FOR REHEARING.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

CASES

DICTIONARY

STATUTE

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To the Honorable Homer T. Bone, Stanley Barnes, Circuit Judges, and John R. Ross, District Judge, of the United States Court of Appeals for the Ninth Circuit:

John Lucas Hudson, Sr., bankrupt, and Pacific-Palmdale Development Company, a corporation, appellants, respectfully petition this Honorable Court for a rehearing in the above-entitled matter and that such hearing be by the court, en banc, all upon the following grounds:

1. The decision on appeal erroneously states California law on

(a) What constitutes wages or salary, and

(b) The assignability of wages or salary;

2. The decision erroneously finds fraud on the part of appellants, basing it mainly on extremely biased and wholly false testimony of trustee's principal witnesses, and incorrect applications of legal precedents;

3. The decision erroneously holds the joint venture contract divisible as to compensation for effort before and after adjudication, and

4. Erroneously upholds an estoppel against appellants, contrary to the record and assuming facts which do not exist.

Preliminary Statement.

If the opinion of this Court of Appeals is allowed to stand, a grave miscarriage of justice will follow. Its recitals sharply oppose appellants' protestations of the bankrupt's honesty. Until Hudson filed his schedules herein, his was a history of honest conduct and the record does not show otherwise. The opinion said of his earlier assignment to creditors "which, so far as we can ascertain, amounted to little or nothing" (p. 2). At Hudson's cost, the assigned property had a value amounting to about $100,000 and included about a dozen valuable trucks, some costly equipment, real estate worth many thousands of dollars and no little bit of cash on hand. What more can creditors expect of a man who fails while working in good faith? The opinion holds him dishonest only because he did not schedule a continuing contract under which he was to receive gain. We are dealing with the Bankruptcy Act and California Labor Code. Both are to be interpreted liberally in favor of the debtor. Hudson claims but the ordinary interpretations of the law and that thereunder he did not have to schedule the contract. The opinion holds that he did, but, we respect-

fully submit that in reaching its conclusions, the opinion ignores plain recitals of California law, misquotes and misinterprets appellants' important authorities, and with a hostility, apparent and unexplained, strains at unfavorable inferences and bars normal inferences from the evidence. By such means, any erroneous decision may be sustained.

In a general résumé of the case it appears that under the joint venture agreement, Exhibit 1, Reeve was obliged to give his associate joint control of the venture funds, purchase orders and subcontracts. These afforded the only supervisory check against Reeve who carried on in his name a contract involving over $1,000,000 in erected bins. From the time the first payment of $100,000 was paid by the government, Reeve refused all joint control and none was ever allowed by him, this resulting in a state court action against Reeve for appointment of a receiver and accounting. A partial audit under court order disclosed that Reeve had used thousands of dollars of joint funds for himself. He opposed vigorously all steps in the state court case which was finally set for trial on October 10, 1955, after pending well over a year. The project promised about $100,000 profit [R. pp. 95, 354]. Of this appellants would receive about $50,000. After payment of $20,000 to Hudson with consent of Pacific-Palmdale Development Company, appellants sought $30,000 more through the action. During its pendency, Reeve and his attorney, Minton, made several threats that if the case was not settled on their terms they would see that Hudson's trustee was informed so he could take over for appellants, who ignored the treat and did not settle. About 4 months before trial date, Minton imparted information resulting in this proceeding. Reeve and Minton testified they never made the threats [R. pp. 118,

180-181]. Granger testified Minton did make the threats [R. p. 259]. Who falsified?

Reeve and Minton, for Reeve's false testimony clearly appears later in the record. Also Minton had known of the pendency of the bankruptcy in the summer of 1954 *before* payment of the $15,000 profit to Hudson [R. p. 180]. Reeve knew of it from the outset [R. p. 178]. If Reeve and Minton were not awaiting an improvement of their position in the state court case through the threat why, with knowledge of the bankruptcy, was their desire for justice to the creditors unexpressed until after $20,-000 had been paid to Hudson and just shortly before trial of the state court case when Reeve must submit his records for thorough inspection and give testimony on his stewardship of over $1,000,000?

Reeve denied Hudson rented the plant site at Sacramento, purchased lumber, arranged for labor and freight cars and set up plant equipment [R. pp. 115, 116]. Yet Reeve had knowledge of this work because no one else did it and he paid the bills, in addition to being at Sacramento during fabrication period at various times. He directed the preparation of Exhibit B for identification but refused to identify it [R. p. 113]. He would not recall Hudson as the moving spirit in procuring the performance bond that saved Reeve from imminent financial ruin under circumstances he could never forget. Reeve testified that on Saturday or Sunday, May 1 or May 2, 1954, just before the bond was put up, he, Hudson, Granger and others were in Reeve's office trying to get the bond [R. p. 107]. There then appears his later refusal to acknowledge that Hudson was then there [R. p. 114]. There are many instances where positive statements of Reeve could have been refuted but for the handicap under which appellants labored at the referee's hear-

ing. The hearing was summary, on five days' notice, but lasted several days and yielded 230 pages of transcribed testimony. The trustee's attorney thought it would require an hour [R. p. 66]. The referee deemed even that a lengthy hearing. The transaction uner scrutiny involved over $1,000,000 in erected bins, 18 months of effort from early April, 1954, to September, 1955, and, besides, was carried on at two sites, Sacramento and Los Angeles, separated by hundreds of miles. Probable witnesses were from a crew of men, disbanded for more than a year at a point far distant from the forum. The difficulties of defending at the hearing were abnormally severe, but were critically so when unexpectedly Reeve put the bankrupt in a bad light by false and uncertain testimony. With a fair chance at preparation, the appellants could have assembled the evidence which would certainly correct much of the wrong impression that Reeve gave.

The projected opinion concedes that appellants may not have had larceny in their hearts (p. 14). This is indeed the fact. But in the same breath, the next to the highest court in a nation dedicated to truth and fair dealing confirms a fraud that does not exist. Appellants have truth and innocence on their side and this must and will be demonstrated.

Grounds for Rehearing.

Appellants contend for this rule of law: If Hudson, at the time of his adjudication, was working under a continuous contract calling for his services, and if his compensation could not be divided into that which was payable for services performed before and after adjudication, and if his substantial effort was essential to complete the work and create the source of his pay, the entire compensation belongs to him and none to his trustee. If this

rule of law applies, Hudson's honesty is established. If it does not apply, he has either misinterpreted the law in nocently or intentionally. But one thing is certain, there is no suggestion of his dishonesty unless that rule of law is rejected under the facts of the case. Appellants complain that the rule of law has been rejected by devices which are not sound and which, if resorted to, could confirm any erroneous decision. Let us consider them.

The opinion holds that Hudson's gain was "profit," not "wages" or "salary" but reaches this conclusion by doing violence to the meanings of ordinary terms and disregarding California statutory and case law on the subject.

Webster's Collegiate Dictionary, Fifth Edition, defines "salary" as a fixed compensation paid for services. It defines "wages" as "pay given for labor—at short, stated intervals as distinguished from salaries or fees." But under the division of Theoretical Economics the term "wages" is defined as including "wages of management or superintendence which are earned by directing the work of others." This is the work that Hudson was to do. He was going to and did set up a crew and manage and superintend their labor in setting up a fabricating facility, and fabricating and shipping bins. Webster says the pay for such work, impliedly involving skill and experience in the work, is a "wage." But the opinion (p. 12) says that under his contract Hudson was to put in "skills and experience" and this entitled him, not to "wages" but a share in the "profits" of the joint venture. At this point let us examine the case of *In re Sieffert,* 18 F. 2d 444. He shared a percentage in "grain" from a ranch operation and did not schedule the contract which entitled him thereto. It was held that he was entitled to such grain as compensation for his skill and experience and he

did not have to schedule it. The opinion seeks to avoid the impact of the *Sieffert* case by saying that because Sieffert had an option to take wages at $40 per month or a percentage of the grain, the "wage" element was wiped out by exercise of the option *after* adjudication. This is specious reasoning and should not be resorted to simply to establish Hudson's dishonesty or to avoid the normal impact of the rule of law giving a bankrupt his earnings after adjudication. Such reasoning is not the liberal construction the law allows to save a man's earnings to him after adjudication. Sieffert had the option when he was adjudicated. Its exercise related back to the commencement of his contract. The option was a property right and to be consistent, the opinion at bar would have to hold that such property right passed to the trustee and the grain was "profit," not "wages" and should have been scheduled. Hence, the opinion at bar and in the *Sieffert* case differ on a simple application of the same rule of law, Sieffert being liberally treated as the law contemplates. The dictionary defines "profits" as "excess of returns over expenditures." Under these normal definitions of the terms, Reeve's share of the gain was "profit" and Hudson's share of the gain was "wages" because they compensated only his services.

The opinion holds definitely that "Hudson was not entitled to wages, nor did the joint venture contract so provide" (p. 13) and also states that even if his compensation was held to be wages, they were unearned at the time of adjudication and being coupled with an interest by contract with Reeve, passed to the trustee under the doctrine of *Cox v. Hughes,* 10 Cal. App. 553, 102 Pac. 956, of which the opinion states "we take to still be the law." This latter statement wholly disregards the provisions of Section 300 of the Labor Code of California

which completely outmodes the *Cox v. Hughes* rule and says no wages shall be assigned unless earned and then only with the signature of the wife of a married debtor. *Lande v. Jurisich,* 59 Cal. App. 2d 613, 616-619, holds that the Labor Law is a remedial statute and *must* be liberally construed to protect the wage earner; also that the law of California was completely changed by the provisions which now appear in Section 300. *Reynolds v. Reynolds,* 14 Cal. App. 2d 481, 58 P. 2d 660, says: "A fee is compensation and compensation is salary." *Kirkwood v. Soto,* 87 Cal. 394, says: "'Wages' and 'salary' as here employed (in legislation) are comprehensive terms and must be interpreted in their broader sense to mean compensation for services, whether such compensation is limited to a fixed sum of money or is payable in fees." In *United States v. Gerdel,* 103 Fed. Supp. 635, 638, it is stated: "California decisions hold that the modern statutory usage of the word 'salary' is intended to embrace all forms of compensation." Appellants urge that under the contract calling for compensation for his services, Hudson's compensation was wages or salary and did not pass to his trustee under the rule.

The opinion denies the application of the case of *In re Leibowitt,* 93 F. 2d 333, and other cases cited on pages 15-18 of Appellants' Opening Brief and completely misstates the rule of the *Leibowitt* case which this very court has cited with approval. The opinion states:

> "The court there pointed out that regardless of the law of the state of domicile the provisions of the Bankruptcy Act cut across state law and that the *right to collect money in the future is such right as will pass to the trustee whether or not capable of being assigned under the state law.*" (Italics added.)

The *Leibowitt* holding is exactly to the contrary as will be noted from these recitals of its opinion:

> ". . . one need only examine the sections of his contract of employment in order to see that substantial service must be rendered by the bankrupt in order that the compensation referred to may become payable by the insurance company. . . . What ever may be the rights of a creditor ordinarily created under the law of New Jersey, the Bankruptcy Act necessarily cuts across such purported rights. It is the undoubted policy of the Bankruptcy Act (11 U. S. C. A., Art. I et seq.), and it is a truly salutary one, that wages earned by a bankrupt after his adjudication become his absolute property. It is true that a substantial portion of the services creating the obligation for compensation were rendered prior to adjudication *but it is clearly stated by the referee* 'there is no way of separating the compensation for what is done (by the bankrupt) before and what is done after adjudication.' Since the productive elements of the bankrupt's labor are inseparable in period of time, we hold that no contract rights therein can be deemed to pass to his trustee." (Italics added.)

In the case at bar the burden was on the trustee to show a separability of the compensation. He did not discharge that burden. The referee did not and could not so find and without the finding his decision was error.

The opinion seeks further to avoid application of the rule by holding the joint venture contract (1) divisible, and (2) if not, Hudson's real effort was only for procurement and ended when the bid to the Commodity Credit Corporation was filed on April 9, 1954, prior to adjudication. The contract calls for "services" in "procuring and performing" a bin building contract. In construing a contract the effort should be, not to force af-

firmance of a trial decision, not to gain money for the creditors, not to define a fraud where but for the forcing none exists, but rather to determine the true intention of the parties by accepted standards of proof. The contract in the case at bar is as indivisible as in the *Leibowitt* case where the court said "one need only to examine the . . . contract to see that substantial service must be rendered" after adjudication. There the court accepted the recitals of the contract to determine indivisibility. Why is this not done in the lower court and on appeal here? In the case at bar we additionally have the parties' declarations of what they intended by the contract: Reeve said, "All I was supposed to do was to handle the financial set up. Mr. Hudson was supposed to have an organization that he would move in to build the bins" [R. p. 129]; "Mr. Hudson was to spend his full time to the execution of the contract in every way he could" [R. p. 130]; "He was to put that knowledge into the grain bin deal and actually do the leg work" [R. p. 73]. Again, when asked if Hudson assisted in "performance" Reeve answered: "He did" [R. p. 94]. He stated Hudson went to Sacramento (after adjudication) for the purpose of setting up the plant [R. p. 115]. Hudson testified that he went to Sacramento and checked in at the Hotel Senator and was continuously there until the 28th setting up an organization when he returned to Los Angeles to help Reeve get a performance bond [R. pp. 224, 225]. Also Reeve stated the bankrupt "has been asked for counsel and collaboration on everything that is entirely on the contract" [R. p. 133]. Here is statement by witnesses on both sides as to their intentions in formulating the contract and how they themselves construed it by performance thereunder. The only feasible import of this evidence is that the parties themselves intended that Hudson should perform as

well as procure and that he did substantial work in actual performance. How can there be any doubt of Reeve's intention in the face of his testimony:

> "Q. Would you have entered into the grain bin contract had it not been for the representation to you by Mr. Hudson of his experience in the building of grain bins? A. No. No. Absolutely not." [R. pp. 139-140.]

By rejecting the plain provisions of the contract which are not divisible, by rejecting the expressed intentions of the parties as to the desired effect of the contract they drew, by rejecting what they did in consummation of the contract, the opinion seeks to make for the parties a contract they did not make for themselves. Even equity will not do this, and certainly it should not be done to establish a fraud where none exists.

The opinion discounts the importance of Hudson's skill and experience in the performance feature of the contract by asking: "What then was there for Hudson to do after a contract had been obtained?" (Op. p. 21) and then proceeds:

> ". . . nothing except being available in the event Reeve wished to consult him . . . 'procurement' was the task to be performed by Hudson and from then on it was up to Reeve to supply all financing, all management, all labor, all material . . ."

Such statements are not proper inferences from and are contrary to the evidence and clash with plain provisions of the contract, the intentions of the parties and their own construction by their conduct. The opinion incorrectly assumes that Reeve could have built the bins and erected them as routine work of a good construction man without Hudson's help once the bin contract was procured. To

be realistic about this subject one must recognize that a "good construction man" who can get a contract to build a $1,000,000 building is established with an office, office force, superintendents and, principally, subcontractors of known quality. How different it is to allow such a man a year or more to build a building in one spot, than to start without plant site, without superintendents, without a force of labor, without materials, without arrangements for freight cars, without operating equipment, to "fabricate" to a 45-day deadline and erect to a 14-day deadline, $1,000,000 in erected bins, with point of fabrication 300 miles from the office and erection 1,500 to 2,000 miles from point of fabrication, fabrication to be by one crew and erection to be by another. The bonding company knew the difference and because of it declined Reeve a bond when Reeve thought he certainly would get it [R. p. 107]. The reason the San Francisco Company issued the bond on Haye's solicitation was because he could assure them that Hudson would be in charge of fabrication and erection and could meet the deadlines and avoid heavy penalties. Had not Reeve had Hudson's experience and skill in mass production Reeve would have finished the experience utterly insolvent.

The opinion seeks to penalize appellants by holding they are estopped to complain that no evidence is in the record which allows a division of the contract into services for procurement and those for performance. The record on this question is that when trustee's counsel sought to get Reeve to divide Hudson's services accordingly, appellants objected. The question and others like it asked for Reeve's opinion only. Reeve was not competent to make that division as that was the province of the court upon competent evidence. The opinion invokes the rule which

is well stated in *Missouri I. & T. Ry. Co. v. Elliott,* 102 Fed. 96, 103, and is clearly to the point that it applies only when a party has, by his objections to *competent* evidence thereby contributed to an *erroneous* ruling which excludes that evidence. All reasons for estoppel exist under such circumstances. But Reeve's opinion was not competent evidence and none to take its place was ever offered [R. pp. 84, 88-89, 123-124]. Reeve testified he had had no discussion with Hudson as to what percentage of his services were in connection with procurement as distinguished from performance after the award of the bin contract [R. p. 130]. Appellants' objections brought about only the exclusion of incompetent opinion evidence. If an estoppel should result therefrom, justice could never follow on appeal, as a case would be presumed if only the excluded incompetent evidence were offered at trial. Appellants' fair treatment of trustee's effort to prove his case at trial is clearly indicated when, little thinking of this issue of estoppel, they avoided nevertheless the effects of it by stating:

> "I would forego my objections to the competency of the witness if the effort were made to establish these points: What did Mr. Hudson do? What time did he put in? What trips did he make? What was his effort? What hours did he put in on the procurement of the contract? I think perhaps Mr. Reeve could testify competently to that within the limits of his own knowledge. . . . Beyond that, we are faced with the bald question of whether or not, under a contract like this, procurement and performance are at all divisible."

Trustee's counsel then said:

> "I will reserve the question and do as Mr. Granger suggests." [R. pp. 89-90.]

Appellants objected only to the opinion of a witness but *offered not to object to facts* on which the court could base a division, if a division were proper. Surely under this record the suggested estoppel does not lie.

The opinion avoids applying the rule of the *Leibowitt* holding by declaring the vital part of Hudson's work of skill and experience and service was done by April 9, 1954, immediately prior to filing of the initial bid with the Commodity Credit Corporation and therefore his compensation for same passed to his trustee on April 19th following. This is not the fact nor the law, as we will show.

As the opinion declares, so did Reeve himself seem to think, that a "good construction man" would be able to do the grain bin job without difficulty and Reeve accordingly thought he could get a performance bond from a surety company that knew him well. Reeve was astounded when that company, *after Reeve had accepted the grain bin contract,* declined to issue the $343,000 bond. The company was of the opinion that the job was beyond Reeve's ability to do [R. p. 107]. Reeve learned of this refusal late in April, *after Hudson had gone to Sacramento* on the 20th to organize the fabrication facility and obtain materials. While at Sacramento, Hudson ordered about $60,000 in materials. When Reeve was refused a bond, it resulted in all Los Angeles surety companies declining thereafter to do so. On April 30, 1954, Reeve did not yet have the bond. Ten days *after* Hudson's adjudication, the bin contract was not yet safely "procured." Reeve was required to deposit a bond of $343,000 within the 10 days or face cancellation. Reeve could not salvage much from the materials then specially ordered and faced a loss which would ruin him financially. On Saturday, May 1, 1954, while Patterson, Wilbur, Reeve, Granger

and Hudson were together in Reeve's office, it was reported erroneously that the contract had been cancelled at Washington. Instantly Reeve broke down and sobbed convulsively as he faced insolvency. It was then that Hudson, performing a task which, as to his compensation, was inseparable from any other effort to "procure" the bin contract, called upon his own skill, experience and contacts and telephoned Hayes at Portland, Oregon, and arranged for Hayes to fly to Los Angeles, which he did, arriving near noon and the next day, Sunday, when he was met at the airport by Granger and Hudson. Throughout the rest of Sunday, Hayes was briefed on the grain bin deal with particular information which was selected and evaluated by Hudson and flew that night to San Francisco where, early Monday morning (the very day the contract was to be cancelled), he obtained the bond. The margin of time was so narrow that to avoid cancellation a telegram was at once sent to Washington stating the bond was in the mail. The day was saved. Reeve was recovered from the very brink of financial ruin all by Hudson's alertness, knowledge and experience, effectively used on *procurement* more than 10 days *after* adjudication. On April 19, 1954, the interest of the bankrupt or Reeve in the grain bin deal, limited by circumstances then known to exist, was not worth a single dollar on the market without application in the future of Hudson's skill, experience and service. When Hudson was adjudicated there was no fixed sum earned and payable without future service and any division of compensation as of then but at a later date is speculative and uncertain and contrary to law.

Pacific-Palmdale Development Company was not the *alter ego* of Hudson. It was formed with Phil Bloom, with no capital structure which allowed for the entry of a financing agency when found and as it might direct.

Hudson would have been but an employee. When suddenly switched to the grain bin deal it lost nothing of its former character. The only difference was that Reeve had his own corporation and Phil Bloom had no interest in the bin deal. Hudson was yet engaged as an employee, all with innocent intent and with no damage to Hudson's creditors because his pay was as subject to their demands while owing by Pacific-Palmdale Development Company as it would be were it owing by Reeve to Hudson. Hudson's connection with Pacific-Palmdale Development Company and the bin deal was never concealed, nor was the fact of his bankruptcy. We have seen that Reeve knew of the bankruptcy at the outset, Minton knew of it before the $15,000 was paid, and more importantly, Hayes, the very man who obtained Reeve's performance bond and was called down to Los Angeles by Hudson, is himself listed as a larger creditor of Hudson in this bankruptcy matter. Hayes obtained the bond for Reeve, not only knowing of Hudson's connection with the deal but because of that very connection.

Had Hudson dealt with Reeve as a joint venturer, under the *Leibowitt* rule Hudson would have been entitled to his earnings under the contract. This being true, his creditors were entitled to no part thereof and so, have no interest in any corporate structure through which Hudson might channel his earnings, even to the point of giving them away. No creditor has been damaged by the family nature of the corporate structure because it did not divert earnings from Hudson nor conceal them. They were paid directly to Hudson by assignment and with-

out any deduction whatever. Under such circumstances it should be clear that no fraud was intended or existed.

In closing we would indicate that portion of the opinion which says that out of the first $42,000 received, $21,000 was paid to Hudson (p. 7) and that this indicated that Hudson was then entitled to one-half share of the profits without anything further to be done on his part (p. 21). No $42,000 payment was ever received. The first payment approximated $100,000 but the $1,000 refund of expenses was at one time, $15,000 was paid at another time and $5,000 paid months later. The state court action was to get the balance of about $30,000 when it became payable. The joint venture agreement contemplated periodic payments to both parties, as the project's requirements might allow. A payment to Hudson no more indicated his work was over than a like payment at the same time (which is how the payments were made) indicated that Reeve's services were also at an end.

It is respectfully submitted that the joint venture agreement is not divisible as to compensation before and after adjudication; that were it divisible there was no evidence or finding as to the rate of division; also that as important services on procurement and performance were performed and required after adjudication, the entire compensation belonged to appellants.

Respectfully submitted,

MERRILL L. GRANGER,

Attorney for Appellants.

Certificate of Counsel.

I, MERRILL L. GRANGER, counsel for Petitioners in the above entitled action, hereby certify that the foregoing petition for rehearing of this cause is presented in good faith and not for delay, and in my opinion is well founded in law and in fact, and proper to be filed herein.

MERRILL L. GRANGER,

Attorney for Petitioners.